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Financial Markets

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Irving Trust

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In spite of the recent run-up in interest rates, the odds now must favor lower long-term rates before year-end. Near term, the outlook is clouded by uncertainty over the timing of the debt-ceiling legislation. Abstracting from this technical element--which in any event ought to be resolved soon--fundamental forces are more likely to be moving rates lower. Primarily, the level of long-term rates seems very high at the moment. Even though arguments based on the level of rates being too high (or too low) frequently are suspect, such an argument is particularly applicable at this time.

The long bond has backed up to a point where its yield has been near 11.8%, close to its peak of 12.15% in early August, when bond market conditions were at their worst. At that time, the monetary aggregate M1 was still above its monitoring range and was giving no signs of behaving. Fed funds rates hovered at 9.75% for a time, and the trend in rates clearly had been upward. The Fed was widely believed to be tightening its policy, with further tightening feared by many. These money market conditions are much different from those that currently prevail--even though the levels of long-term rates are similar.

The most obviously different element is that the Fed funds rate is lower, near the level of 9.38% to 9.25%. Also, M1 is very well behaved and might even break through the bottom of its growth range. Under such circumstances, the market does not see Fed tightening as its worst problem, particularly as the Fed funds rate has been trending downward since early August. Furthermore, bank reserve data indicate that the Fed has taken a much more accommodative stance in the money market. The Fed has not been so lenient that one could say that it is pushing rates down, but the Fed stopped tightening and clearly is fostering stable rates at a lower level, even if it is not prepared to do more at the moment.

Skeptics still may hold that the market has more to fear than just the Fed--and that is true. However, it is rare for long rates to rise unaccompanied by short rates. The current rise in rates, except for Fed funds, has been led by the long end and has pulled up the short end. The failure of the funds rate to validate the rise in market rates argues for the temporary nature of the rise. Economic recovery is still too new to give credence to fears that crowding out effects are setting in and forcing rates higher. Moreover, long-term rates are extraordinarily high for this point in the business cycle. The Fed has been implementing a very forward-looking policy throughout this recovery, and that is unlikely to mean that rates will rise again from these levels. Thus the configuration of longer-term market rates is likely to be reestablished off of the current level for Fed funds. A heavy calendar of Treasury auctions may slow down this adjustment, but I don't think it will stop it. And, even though the economy has been very strong, I don't believe that strength will continue without lower interest rates: Medium term, economic performance is the key; short term, events remain dominated by technical factors.

Robert A. Brusca

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Market Yields

	11/10/83 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	11.00%	11.00%	12.00%
Effective since	8/8/83		
Discount Rate at Federal Reserve Bank	8.50	8.50	9.50
Federal Funds	9.38	9.31	9.50
Repurchase Agreements	9.25	9.25	9.13
U.S. Treasury Issues			
Bills			
3 months	9.08	9.09	8.48
6 months	9.48	9.45	8.92
1 year	9.85	9.94	9.15
Coupons			
2 years	10.66	10.71	9.81
4 years	11.22	11.24	10.29
7 years	11.71	11.69	10.58
10 years	11.92	11.80	10.54
Long Bond	11.84	11.90	10.42
Negotiable Certificates of Deposit-Secondary Market			
1 month	9.20	9.25	8.95
3 months	9.35	9.45	9.10
6 months	9.55	9.55	9.30
1 year	9.95	10.00	9.75
Banker's Acceptances			
1 month	9.20	9.25	8.85
3 months	9.42	9.45	8.90
6 months	9.55	9.63	8.95
Eurodollar Deposits			
1 month	9.63	9.68	9.63
2 months	9.81	9.87	9.75
3 months	9.88	9.94	9.88
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	9.29	9.29	8.89
1 month	9.35	9.33	8.94
3 months	9.49	9.34	8.81
Bank Holding Companies			
1 month	9.25	8.94	7.91
Dealer Placed:			
3 months	9.49	9.38	8.41
New AA Corporate Utility Bond	13.10	13.20	11.90
Tax Exempt			
6 month Project Notes	5.40	5.35	4.00
1 year AAA Bond	5.30	5.30	5.50
5 year AAA Bond	6.80	6.80	7.00
20 year AAA Bond	9.20	9.10	9.40

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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